




## Department of Energy

Washington, DC 20585

September 26, 2007

### MEMORANDUM FOR DISTRIBUTION

FROM:

  
DEAN G. OLSON, DIRECTOR  
OFFICE OF FINANCE AND ACCOUNTING

SUBJECT:

Supplemental Guidance on Accounting for Capital Leases

The Office of Finance and Accounting developed the attached "Guidance on Accounting for Capital Leases" to delineate DOE financial guidance with respect to recording capital leases. The guidance includes accounting criteria for classifying a lease as either capital or operating and provides pro forma accounting entries to be followed for property, plant and equipment acquired through capital leases. The accounting entries cover both funded and unfunded capital leases.

Should you have questions or comments regarding the guidance, please contact Greg Dulovich at (301) 903-4701 or email [greg.dulovich@hq.doe.gov](mailto:greg.dulovich@hq.doe.gov).

Attachment

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# Department of Energy



Office of Finance and Accounting

Guidance on

Accounting for Capital Leases

September 2007

## **GUIDANCE ON ACCOUNTING FOR CAPITAL LEASES**

### Introduction

Leases may be either operating leases or capital leases. Operating leases of PP&E are leases in which DOE does not assume the risks of ownership of the PP&E. Federal accounting standards establish four criteria for classifying a lease as a capital lease. If the lease meets one or more of these criteria, the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.

### Capital Leases

Capital leases are leases that transfer substantially all the benefits and risks of ownership to DOE. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by DOE.

- The lease transfers ownership of the property to DOE by the end of the lease term.
- The lease contains an option for DOE to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

When DOE enters into a capital lease, sufficient budget authority is required to equal the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. This amount should be recorded by DOE as a capital lease liability (SGL 2940F000). However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the capital lease liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.

The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be DOE's (Treasury's) incremental borrowing rate unless (1) it is practicable for DOE to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than DOE's (Treasury's) incremental borrowing rate. If both these conditions are met, DOE shall use the implicit rate. DOE's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.

During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. Additional annual budget authority will be required for the interest expense plus any other annual operating expenses to be paid over the lease term.

The cost of general PP&E acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified above, unless the net present value exceeds the fair value of the asset).

An exception to the full funding requirement is for computer acquisitions where there are demonstrable benefits over outright purchase of computers. Contracts awarded under this authority shall contain language stipulating zero dollars or clearly stated dollar ceilings for cancellation liabilities, and expressly state that no further obligations are allowed unless appropriations are provided for the computer acquisition in advance of the next fiscal year's obligation. Where questions arise concerning funds obligation for a particular computer acquisition contract, discussions are encouraged with the responsible contracting officer, a representative of the Office of the Chief Financial Officer, and legal counsel before the contract is awarded.

### Operating Leases

A lease that does not meet at least one of the criteria noted under "Capital Leases" above should be classified as an operating lease.

Operating leases of PP&E are leases in which DOE does not assume the risks of ownership of the PP&E. Budget authority must be available to cover DOE's maximum liability, including any termination costs, before the lease is signed.

Rents paid to a lessor at the beginning of a rental period are typical prepaid expenses. Advances and prepayments should be recorded as assets. Advances and prepayments are reduced and cost recognized when goods or services are received, contract terms are met, progress is made under a contract, or prepaid expenses expire.

Rent due to a lessor is recognized as accounts payable.

### Definitions

- Capital leases – Leases that transfer substantially all the benefits and risks of ownership to the lessee.
- Executory contract – A contract which has not been performed by all parties to it.
- Executory costs – Those costs such as insurance, maintenance, and taxes incurred for leased property, whether paid by the lessor or DOE.
- Operating lease – An agreement conveying the right to use property for a limited time in exchange for periodic rental payments.

### PP&E Acquired via Capital Leases (Funded Capital Lease)

The following entries should be made at the inception of the capital lease in the amount of the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. It should be noted that entries are for a regular no-year fund. Some of the budgetary-type accounts vary for other types of appropriations, such as the Nuclear Waste Fund or for expired appropriations.

To record signed capital lease contract.

The following entries should be made by DOE to record the obligation:

DR	46101300	
	CR	48010000
DR	10102000	
	CR	10101100
DR	31011100	
	CR	31012000

To record acquisition of capital lease PP&E asset.

The following entries should be submitted by the integrated contractor:

DR	88020100	
	CR	88010100
DR	18100000	
	CR	2940F000

The following entries will be generated by the integrated contractor interface based on Transaction Code definition:

DR	31070900	
	CR	57000000
DR	48010000	
	CR	49010000

The following entries should be made periodically to record capital lease payments, interest, and depreciation.

To record accrued interest.

The following entries should be submitted by the integrated contractor:

DR	99200000	
	CR	99210000
DR	63300000	
	CR	21400000

The following entries will be generated by the integrated contractor interface based on Transaction Code definition:

DR	31070900	
	CR	57000000
DR	48010000	
	CR	49010000

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To record lease payment (including interest).

The following entry should be submitted by the integrated contractor:

DR 2940F000

DR 21400000

CR 57900400

The following entries will be generated by the integrated contractor interface based on

Transaction Code definition:

DR 57900500

CR 10100300

DR 49010000

CR 49020000

To record depreciation expense.

The following entry should be submitted by the integrated contractor:

DR 67100100

CR 18190000

#### PP&E Acquired via Capital Leases (Unfunded Capital Lease)

The following entries should be made at the inception of the capital lease in the amount of the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. It should be noted that entries are for a regular no-year fund. Some of the budgetary-type accounts vary for other types of appropriations, such as the Nuclear Waste Fund or for expired appropriations.

To record acquisition of capital lease PP&E asset.

The following entries should be submitted by the integrated contractor:

DR 80300300

CR 80300400

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Note:

- SGL 80300300 should be reported on the DOE PP&E Roll-Forward (Allottee) Report as part of capitalized acquisitions.
  - SGL 80300300 should not be reported on the Statement of Financing line, "Resources that Finance the Acquisition of Assets."
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DR 18100000

CR 2940U000

The following entries should be made periodically to record capital lease payments for principal and interest.

The following entries should be submitted by the integrated contractor:

DR 88020500 – Financing for Previously Unfunded Capital Lease PP&E

CR 88010500 – Financing for Previously Unfunded Capital Lease PP&E  
(Contra)

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Note:

- SGL 88020500 should be reported on the Statement of Financing line, "Resources that Finance the Acquisition of Assets."
  - SGL 88020500 should not be reported on the DOE PP&E Roll-Forward (Allottee) Report as part of capitalized acquisitions.
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DR 2940U000  
     CR 2940F000  
 DR 99200000  
     CR 99210000  
 DR 2940F000  
 DR 63300000  
     CR 57900400

The following entries will be generated by the integrated contractor interface based on Transaction Code definition:

DR 31070900  
     CR 57000000  
 DR 48010000  
     CR 49010000  
 DR 49010000  
     CR 49020000  
 DR 57900500  
     CR 10100300

To record depreciation expense:

The following entry should be submitted by the integrated contractor:

DR 67100100  
     CR 18190000

### Capital Lease Footnote Disclosure Requirements

Capital leases are contractual agreements that become liabilities when certain conditions are met. As part of the Headquarters' yearend closing guidance, an Excel template is provided to compile capital lease information for SGLs 1810, Assets Under Capital Lease, 1819, Accumulated Depreciation on Assets Under Capital Leases, and 2940, Capital Lease Liability. Each Field Office, PMA, and FERC should provide the following information:

1. Capital leases (Assets) - Provide the Federal and non-Federal amounts for capital lease assets (SGL 1810) and accumulated depreciation/amortization (SGL 1819), by major asset category in accordance with the Headquarters' yearend closing guidance. The category of capital lease assets (SGL 1810) should be reported consistent with the STARS asset type value assigned to the capital lease asset.
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2. **Capital leases (Liabilities) – Provide SGL 2940, Capital Lease Liability, information for capital leases. This information should include SGLs 2940F000 (funded) and 2940U000 (unfunded) showing the Federal and non-Federal amounts of future minimum lease payments, imputed interest, and executory costs, including any profit, for the current and prior years. Amounts reported must agree with the STARS SGLs 2940F000 and 2940U000.**
3. **For capital leases greater than \$5 million, narrative disclosures for the major asset categories should be provided to identify funding commitments associated with the lease terms such as: the basis for contingent rental payments, existence and terms of renewal options or purchase options, escalation clauses, restrictions imposed by lease agreements, and the amortization period.**